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Dear Madam

**SUBMISSION WITH REGARD TO THE VALUE OF RESIDENTIAL
ACCOMMODATION PROVIDED TO AN EMPLOYEE**

The sub-committee of SAICA responsible for employees' tax related issues (a sub-committee of the SAICA National Tax Committee) identified various practical difficulties with regard to the use of the rental value where an employer provides residential accommodation to an employee. This submission deals with the issues identified and our proposals.

The Minister of Finance in the 2012/2013 budget stated the following under the heading "Determination of the value of fringe benefits":

"In certain cases, the Income Tax Act prescribes the use of a formula to calculate the value of a fringe benefit to be taxed in the hands of the employee. However, in these cases, it is sometimes possible for the employer to determine or obtain the actual cost of providing the fringe benefit to the employee (for example, actual business and private kilometres travelled by an employee using a company vehicle, and employers that provide rented vehicles to their employees as "company vehicles"). To create a better match between the employees' tax withheld and the tax calculation on assessment, it is proposed that, where possible and practical, the employer be allowed to use actual cost to determine the value of the fringe benefit for the employee".

We submit that a similar mismatch occurs where employees are provided with residential accommodation.



THE LAW

The taxable benefit, where an employee is provided with residential accommodation, is defined in paragraph 2(d) of the Seventh Schedule and paragraph 9 of the Seventh Schedule then provides the method to be used to determine the value thereof. The value is referred to as the “rental value” and is the greater of an amount determined in accordance with a formula or the actual rental paid. The formula will generally apply where full ownership of the accommodation vests in the employer. The formula used to determine the value of the benefit is based on the previous year’s remuneration of the employee and the size of the accommodation and the services included.

PROBLEM

It is clear from the law that the formula amount must be used even where it is greater than the actual cost to the employer.

The formula derives its value from the “remuneration factor” and this presents the following problems or anomalies:

The definition of remuneration for purposes of determining the rental value:

The “remuneration factor” uses the remuneration of the employee derived in the preceding year of assessment as a starting point (the instance where the employee was not in the employ of the employer in the previous year is not relevant to the problem). Remuneration in turn is the remuneration for employees’ tax purposes (as defined in paragraph 1 of the Fourth Schedule). Whilst the definition only includes amounts derived by the employee from the employer and excludes any restraint of trade payment it will include certain lump sums and discretionary payments. (Note: Paragraph 9(1) still refers to a sub-item of the definition of gross income in paragraph 1 of the Fourth Schedule that has been deleted (the item concerned is (vii) of the amounts excluded)).

The lump sums referred to relate to bonuses, amounts in respect of the variation of employment and the discretionary amounts relate to gains in respect of qualifying equity shares (section 8B) and the vesting of equity instruments (section 8C). It is submitted that these can significantly distort the earnings of an employee in a particular year and thereby create an inflated benefit. The employee is then taxed on an amount that is not necessarily equal to the value of the benefit enjoyed.

The anomaly that arises from the use of the formula where essentially the same benefit is provided to employees deriving different amounts of remuneration:

This is best illustrated by an example:

The remuneration factor of Employee A is R150, 000 whilst that of Employee B is R400, 000. They are each provided with a similar fully furnished apartment owned by the employer with all services included for a period of six months.



The rental value will then be as follows:

Employee A	Employee B
$(R150,000 - R63,556) \times 19/100 \times 6/12$ = R 8,212.18 for the 6 month period = R 1,368.69 taxable fringe benefit per month	$(R400,000 - R63,556) \times 19/100 \times 6/12$ = R31,962.18 for the 6 month period = R 5,327.03 taxable fringe benefit per month

It is clear that the rental value for two employees receiving the same type of accommodation will be substantially different whilst the benefit is the same. The employee with the higher remuneration factor will pay more tax. This is considered not to be equitable.

It is true the Act (paragraph 9(5)) permits the employer to approach SARS to use a lower value (a “fair and reasonable value”) where the situation, nature or condition of the accommodation or any other factor will satisfy SARS that it is appropriate to do so. There is no guidance as to what “other factor” SARS will consider in this regard. This results in an administrative burden both for the employer and SARS.

If a market related value was obtainable and allowable as the taxable value the individuals would be taxed on the same amount at their respective marginal rates.

The anomaly that arises in respect of employees whose usual place of residence is outside the RSA:

This is another instance where the rental value is in most instances in excess of a fair and reasonable value. The problem arises because the Act requires (paragraph 9(3A)) that the value of the benefit must be the greater of the formula amount and the actual cost.

The following example illustrates this:

Employee A’s usual place of residence is not in the RSA and he is on a one year assignment in the RSA. His remuneration factor is R1, 800, 000 due to the assignment allowances provided and he is provided with a one bedroom fully furnished and serviced apartment for which the employer pays R10, 000 per month.

The amount in terms of the formula will then be:

$$\begin{aligned} & (R1, 800, 000 - R63, 556) \times 19/100 \times 12/12 \\ & = R329, 924 \text{ for the 12 month period} \\ & = R27, 493.66 \text{ taxable benefit per month} \end{aligned}$$

Under paragraph 9(3) the rental value will be R27, 493.66 per month being the greater of the formula amount (i.e. R27, 493.66) or the rental paid (i.e. R10, 000 per month). This rental value also exceeds the monthly limit of R25, 000 provided for in paragraph 9(7B) and the



excess will therefore be subject to tax. It is clear that the formula amount in this instance bears no relation to the actual cost of the accommodation provided (the R10, 000).

The only remedy in this instance is again for the employer to approach SARS and request a lower value in terms of paragraph 9(5). This results in an administrative burden both for the employer and SARS.

The rental value where two employees share the same residential accommodation:

A further difficulty arises where employees share the same employer provided residential accommodation. No provision exists in the current legislation to deal with this situation. It is inequitable for both employees to be taxed on the full benefit as they do not enjoy the full benefit of the accommodation.

The following example illustrates this:

Employees A, B and C are provided with a three bedroom fully furnished house for the duration of their one year assignment in the RSA. The employer rents this property for R20, 000 per month which is paid for by the employer. The remuneration factor for each employee is R250, 000.

Based on current legislation the amount in terms of the formula will then be:

$$\begin{aligned} & (R250, 000 - R63, 556) \times 19/100 \times 12/12 \\ & = R35, 424.36 \text{ for the 12 month period} \\ & = R2, 952.03 \text{ taxable benefit per month.} \end{aligned}$$

For the three employees the cumulative taxable benefit is therefore R8, 856.09 with each of them being taxed as if they were the sole occupant of the premises. The taxable benefit bears no relation to the market-related cost of the accommodation.

PROPOSAL

It is proposed that the legislation relevant to residential accommodation provided by an employer to an employee must be amended as follows:

1. In all instances where the actual cost to the employer of providing the fringe benefit to the employee is available the rental value of the relevant accommodation must be equal to the actual cost.
2. Relating to the use of the formula:
 - a. The use of the formula to determine the rental value must be revised and remuneration should be removed as the determining factor in the calculation of the rental value. The use of a market related rental or a percentage of the



- municipal rate value of the property should be considered as an alternative to the formula.
- b. Where a market related (arms length) rental value is determinable for employer-owned accommodation, the employer should have the option to use this value to determine the rental value without the administrative burden of applying to the Commissioner for rulings under paragraph 9(5). A provision that requires the employer to be satisfied that the value being used in the determination of the fringe benefit is market related/arms length is suggested and that the employer is therefore required to maintain some documentary proof of research or information obtained in order to satisfy himself as to this fact.
 - c. For those types of employer-provided accommodation where no market value can be determined such as in the farming, mining or forestry industries, a formula based approach with a narrow definition of remuneration could then be used to determine the value of the benefit.
 - d. With regard to the definition of remuneration for purposes of determining the remuneration factor it is suggested that bonuses, discretionary lump sums and share gains be excluded.
3. The legislation should allow for the apportionment of the rental value where the same accommodation is occupied by more than one employee at the same time. We would suggest the insertion of a paragraph 9(6A) to provide for the basis of the apportionment of the rental value accommodation under these circumstances.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

PJ Nel CA(SA)

PROJECT DIRECTO TAX

The South African Institute of Chartered Accountants

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